David A Kirby 12/22/2008 10:00:58 AM From DB/Inbox: David A Kirby

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UNCLASSIFIED
TELEGRAM December 18, 2008

To: SECSTATE WASHDC - ROUTINE

Action: AF

From: AMEMBASSY PRETORIA (PRETORIA 2735 - ROUTINE)

TAGS: BEXP, ECON, EFIN, EINV, EMIN, ENRG, ETRD, KTDB, SF

Captions: USDOC

Subject: SOUTH AFRICAN RESERVE BANK CUTS INTEREST RATE

Ref: None

Additional Addressees:
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cc:
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E.O. 12958: N/A
TAGS: ECON EFIN EINV EMIN ENRG ETRD BEXP KTDB SF
SUBJECT: SOUTH AFRICAN RESERVE BANK CUTS INTEREST RATE

¶1. (U) Summary. The South African Reserve Bank's Monetary Policy Committee (MPC) reduced the key policy interest rate, the repo rate, by 50 basis points to 11.5 percent, on December 12, 2008. The rate cut was made possible by declining domestic inflation and weakening domestic and international economic conditions. The MPC expects inflation to return to within the target range of 3-6 percent in the third quarter of 2009, with the weaker rand as the most significant upside risk to the inflation outlook. Most analysts believe there will be further interest rate cuts in 2009. End Summary.

Interest Rate Cut

¶2. (U) The South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) reduced the key policy interest rate, the repo rate, by 50 basis points to 11.5 percent, on December 12, 2008. This was the first interest rate cut since April 2005. The MPC explained in a public statement that its decision was made in view of the moderating inflation outlook and indications that inflation would decline further over the coming months.

Domestic Inflation Developments

¶3. (U) Data released by Statistics South Africa (StatsSA) showed that CPIX inflation (CPI minus mortgage interest) declined from a high of 13.6 percent in August 2008 to 12.1 percent in November. Food, fuel and electricity prices were the main contributors to inflation, despite fuel price reductions in September, October and November. Producer price inflation also showed signs of moderation in the past two months. Agricultural food prices declined for the third successive month in October, when the year-on-year rate declined to 10.4 percent.

Global Economic Slowdown

¶4. (U) According to the MPC's statement, it also took into account the impact of the global economic slowdown on the South African economy and inflation. The MPC expects declining commodity prices, particularly the significant drop in international oil prices, as well as a decline in the volume of world trade (which has lowered transport costs) to contribute to downward inflation pressure.

Domestic Economic Conditions

¶5. (U) The MPC noted that domestic economic conditions have weakened since the October MPC meeting and that this will contribute to a more rapid decline in inflation than was initially anticipated. [Note: GDP growth eased significantly in the third quarter to only a 0.2 q/q annual rate, as the mining, manufacturing as well as retail and wholesale trade sectors contracted. End Note.]

Inflation Outlook

¶6. (U) The MPC's most recent central inflation forecast showed a further improvement in the inflation outlook from the previous estimate. Inflation is expected to continue its downward trajectory and to return to within the inflation target range in the third quarter of 2009 (previously the second quarter of 2010). Inflation is expected to average 6.2 percent and 5.6 percent in 2009 and 2010, respectively. The MPC pointed out that its forecasts were subject to more uncertainty than usual, given the volatile global environment, and the uncertainty related to the impact of the Qenvironment, and the uncertainty related to the impact of the rebasing and reweighting of the CPI basket to be introduced by StatsSA in January 2009.

Risk to Inflation

¶7. (U) The MPC highlighted the exchange rate as the most significant upside risk to the inflation outlook. The rand has lost 11 percent of its value against the dollar and 7.6 percent against the trade-weighted basket of currencies since the last MPC meeting. The SARB attributed the depreciation in the value of the rand to risk aversion prevailing in the current uncertain global environment.

Local Reaction

¶8. (U) The MPC's decision to cut interest rates was welcomed by most analysts, although some were hoping for a full percentage point cut. SARB Governor Tito Mboweni told reporters that a more aggressive move was discussed but not adopted by the MPC because of inflation risks posed by rand weakness. An ABSA Bank Economist told Embassy Economic Specialist that the strong deterioration in the global economy, the slowdown domestically and the decision by numerous other central banks worldwide to cut interest rates motivated the decision to cut interest rates. Most economists expect further interest rate cuts in 2009.

Comment

¶9. (U) The key focus will now be the pace of the SARB's easing cycle. The MPC's current inflation forecast as well as slower growth in South Africa and globally provide a green light for an accelerated pace of monetary easing in 2009.

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